



Tax Information Bulletin

STATE BOARD
OF EQUALIZATION

ISSUED QUARTERLY
June 1997

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1. Annual Taxpayers' Bill of Rights Hearings Planned

Each year, the Members of the Board of Equalization hold public hearings to give taxpayers an opportunity to present recommendations regarding legislation, the quality of agency services, and other topics related to the Board's administration of its tax programs.

The following hearings have been scheduled for this year:

Culver City. Thursday, October 23, 1997, at 1:30 P.M., in the Board of Equalization's district office, 5901 Green Valley Circle, Suite 200.

Sacramento. Wednesday, November 19, 1997, at 1:30 P.M., in the Board Room located on the first floor of Capitol Square, 450 N Street, Sacramento.

Although you do not need to be scheduled in advance to speak at the hearing, it would help us prepare if you contacted us before the hearing to let us know your topic. If your proposal is complex or extensive, we encourage you to submit it in advance and then summarize it in your oral presentation.

To notify us of a topic you wish to discuss or to send written material in advance, please contact:

Taxpayers' Rights Advocate
P.O. Box 942879
Sacramento, CA 94279-0070
Telephone: 888-324-2798
Fax: 916-323-3319

2. Tax Talk '97 Teleconference Scheduled for October 7

As its name implies, "Tax Talk" is about taxes—specifically, about taxes and how they affect businesses. At this year's teleconference, tax experts will talk about a



variety of issues, including general partnerships, unemployment insurance rates, sales tax exemptions, wages, penalties, and trusts. These and other topics will be presented by the Board of Equalization, Internal Revenue Service, Employment Development Department, and Franchise Tax Board.

Tax Talk '97, to be held on October 7, will be broadcast to 22 locations in California and to sites in Ashland, Oregon and Reno, Nevada. A large attendance is anticipated. In fact, last year 1200 professionals attended, including tax preparers, business executives, taxpayers, and government officials.

The seminar is sponsored by the participating agencies and the School of Business Administration at California State University, Sacramento, and is produced by the University Media Services.

Attendees will be able to submit questions to the experts (question cards will be made available at each location, and site facilitators will call in the questions).

The tuition for the seminar is \$150 for those whose payment is received by September 19, 1997 (late registrants will be charged \$195). Tuition includes lunch, refreshments, and class materials.

Tax Talk registrants can earn up to eight hours of credit toward the continuing education requirements of the California State Board of Accountancy, the California Tax Education Council, and, for enrolled agents, the Internal Revenue Service.

Tax Talk brochures will be mailed in late June to previous attendees and others who have been identified as potential registrants. If you would like to request a brochure, please call 916-845-7070. Or write to Tax Talk, Franchise Tax Board, P.O. Box 520, Rancho Cordova, CA 95741-0520. Space is limited, and some locations fill up quickly.

3. Are You Required to Open Your Business Records to Local Tax Consultants?

Because local governments and special tax districts receive a portion of the sales and use taxes reported to the Board, many of these jurisdictions contract with "local tax" consultants or other such representatives to examine Board records to verify whether tax revenues have been properly allocated.

Although the Board is required by law to provide these representatives access to Board sales and use tax records related to a particular jurisdiction, the law does not require that you provide them access to your books and records.

If you are contacted by a local tax consultant, or other such representative, requesting access to your books and records to verify that you have correctly reported local or district taxes, you do not have to provide access unless you desire to do so. Although a local tax consultant may represent your local or district taxing jurisdiction, he or she does not represent the Board and does not possess the statutory authority for the examination and verification of your books and records as that held by Board audit staff.

4. Sales and Use Tax Short Form Continues To Be a Success

If you are looking for a simpler way to file your sales and use tax return, our short form may be the answer. Many businesses have found it easier to pay their sales tax liabilities since they began filing on the short form BOE-401-EZ, a simplified sales and use tax return.

The EZ form is designed primarily for businesses whose sales are made within the county in which they are located. However, the form may not be used if

- You sell fuel, automobiles, boats, aircraft,



or makes sales to aircraft common carriers.

- You claim credit for sales tax paid to other states.
- You claim an exemption for fixed-price contracts or leases.
- You claim deductions for returned merchandise, tax-paid purchases resold, cash discounts, bad debts, or claim exemptions not provided for on the return.

If you think you qualify and would like to begin receiving the short form, please call the Information Center at 1-800-400-7115.

5. Tax Rate Changes—Do They Apply to Your Contracts and Leases?

Whenever there is a change in the sales and use tax rate (for example, voters approve a new tax district or an existing one expires), you may wonder what to do for sales and purchases made under an existing contract or lease. Which rate should you apply? The rate specified in the contract or lease, or the new rate?

To decide which rate to use, you must first determine whether your contract or lease qualifies for an exclusion from a tax rate increase. To qualify, all costs must be fixed at the outset (that is, the prices agreed to cannot be changed); neither party can have the unconditional right to terminate the contract or lease; the tax amount or rate must be specifically stated in the contract or lease agreement; and there cannot be a provision in the contract or lease for an increase in the amount of tax.

If your contract or lease meets the above conditions, you should continue to use the tax rate or amount specified in the contract if the new rate is higher. However, if the new rate is lower, you should use the lower rate for taxable transactions that occur on and after the effective date of the rate change.

Note—mobile transportation equipment. The

guidelines stated in the previous column do not apply to leases of mobile transportation equipment under a fixed-price contract. To determine the applicable tax rate that applies to your leases of mobile transportation equipment, please refer to Regulation 1661(b)(2)(B). If you need a copy of this regulation, please call our Information Center (see page 8).

6. Mailed Returns Must Be Postmarked by Due Date

To avoid penalty and interest charges for late filing, mailed returns, forms, and payments must be postmarked on or before the specified due date. When mailing your return, please be sure to do so before the daily postal pickup to ensure a timely postmark. If the due date falls on a Saturday, Sunday, or State holiday, returns that are postmarked by the next business day will be considered timely. A return or payment postmarked after the due date may be considered timely if you provide satisfactory proof that it was mailed on time, with sufficient postage, to the proper address.

7. Taxability of Vending Machine Food Product Sales

If you sell food products through vending machines (other than bulk vending machines, which are discussed later), you are generally required to report tax on all food product sales, including sales of beverages, hot prepared food products, candy, and candy-coated gum.

However, a partial tax exemption is available for your sales of cold food products, hot coffee, hot tea, and hot chocolate. As of 1990, only 33% of your gross receipts from those sales is taxable. Provided you properly post a notice stating that all prices of taxable items include sales tax reimbursement (for the amount due on the taxable portion), you may



adjust your taxable sales for the sales tax included.

For more information on how to make this adjustment and the type of statement that must be posted, please call the Information Center at 1-800-400-7115 and request a copy of Regulation 1574, *Vending Machine Operators*. This partial exemption does not apply to your sales of hot prepared food products (except hot coffee, hot tea and hot chocolate) or carbonated beverages. Sales of these items are fully taxable.

Bulk vending machine sales. "Bulk vending machine" means a vending machine containing unsorted food products, which upon insertion of a coin, dispenses those products in approximately equal portions without selection by the customer. You are not required to report tax for sales of food items from bulk vending machines *if the amount of each sale is twenty-five cents (\$0.25) or less*. For tax purposes, you are considered the "consumer" of these items. (Bulk sales do not include sales of hot prepared food products or beverages.)

8. Common Errors Discovered in Audits: Cash Basis Reporting

When you report and pay your sales tax liability, you must report on the accrual basis—even if you report on a cash basis for income tax purposes. Reporting on the "accrual basis" means that you must report and remit the tax in the tax reporting period in which the sale takes place—regardless of when you receive payment.

Under the Sales and Use Tax Law, a sale takes place when you transfer title or possession of an item to the buyer (or to another person at the direction of the buyer). Consequently, even if your customer pays for the item after the reporting period, you cannot defer your tax payment until you have received full payment.

You must report the sale for the reporting period in which the sale took place. If you do not, or if you file your return or make your tax payment after the due date on the return, you are liable for any overdue taxes plus applicable interest and penalty charges.

However, rental payments for the lease of property other than mobile transportation equipment are treated differently. When tax is reported based on rental receipts for such property, you do not need to report and remit your tax liability until you have been paid by the lessee.

What if I pay tax on the accrual basis, but my customer does not pay me?

If you reported a taxable sale that is later found to be uncollectible, you may be able to take a bad debt deduction on your sales and use tax return. For more information concerning an allowable bad debt deduction, please call our Information Center and request a copy of Regulation 1542, *Bad Debts*.

9. Taxable Charges To Process Materials for Lump-Sum Contracts

The following article explains the taxability of charges made by third party contractors who are hired to process construction materials for an installing contractor. The following information does not apply to fixtures.—Editor

If you are a contractor and furnish and install construction materials under a lump-sum contract, you are generally considered the "consumer" of the materials for tax purposes. This means that your purchases of such materials are subject to tax. It also means that if the materials you furnish require further processing before they can be installed and you hire a third party to have this work done, the third party's labor or service charges are generally subject to tax. This is true whether



or not the third party originally sold you the materials.

The person or company you hire to process or fabricate the materials must pay sales tax to the Board for those charges if the work is done in California. If the processing or fabrication work is done outside California, you, as the consumer, must generally report use tax for those labor or service charges.

Example: You have contracted (under a lump-sum contract) to install a stone wall and purchase stone slabs for this purpose. The stone slabs require further cutting (processing) before they can be installed. You hire a third party to cut the stone, and the work is done in California. In this example, the person or company you hired to do this work must report sales tax on the charges for performing this service.

Besides labor charges, the third party may bill for associated charges, such as “downtime,” “rush charges,” or “mobilization charges.” As with the labor charges, these associated charges are subject to tax since they are considered part of the charge for processing or fabricating the materials to be used in the completion of the installing contractor’s lump-sum contract.

Please note. The application of tax could differ from that described above if you, as the installing contractor, process or fabricate the materials. It may also differ if you contract to furnish and install fixtures or if the contract is other than lump sum.

For additional information on how tax applies to construction contracts and what constitutes materials and fixtures, please contact our Information Center at 1-800-400-7115 and request a copy of Publication 9, *Tax Tips for Construction and Building Contractors*, or Regulation 1521, *Construction Contracts*.

10. Are You Scheduled for an Appeals Conference?

If you have filed an appeal with the Board and requested a hearing of your case, you may be scheduled for an Appeals conference with the Appeals Section. If you are, you will find that arranging such a conference has been made a lot easier.

The Appeals Section is independent of the Sales and Use Tax Department and the Special Taxes Department, and its auditors and attorneys will have had no prior involvement with your case. Attorneys are assigned to cases that involve legal issues, and auditors are assigned to cases that involve only audit issues.

In the past year, the Section has taken steps to make it more convenient to hold Appeals conferences. If you are scheduled for a conference, you will be given the following choices:

- You can travel to Sacramento and meet at a time that is mutually convenient to you and the Appeals Section.
- You can request a telephone conference that is mutually convenient to you and the Appeals Section, and the Board will pay for the call.
- You can attend a conference at one of our designated local offices. The time will be set by the Appeals Section, and you will be given 30 days notice of the conference.

Video conferences are available for out-of-state taxpayers. The Board is involved in a pilot program to evaluate the effectiveness of video conferences. Currently, such conferences are available to out-of-state taxpayers who may prefer this method over having to wait for an attorney or auditor to travel to a Board district office in Chicago, Houston, or New York. If the program is successful, it may be extended to taxpayers located in California.



11. Clarification: Allocation of 1% Local Tax on Long-Term Leases of Motor Vehicles

If you are a lessor of motor vehicles, you should have received a notice regarding recent changes in the method used to allocate the 1% local use tax due on your rental receipts. The notice explains not only the guidelines for reporting the local use tax, but also explains other significant changes, such as the definition of what constitutes long-term and short-term leases and the definition of "motor vehicle" for purposes of the new allocation requirements.

If you did not receive this notice and believe you are affected by these changes, please call our Information Center at 1-800-400-7115 and request a copy (*Special Notice: Motor Vehicle Leases, Clarification of How To Allocate Local Use Tax*, February 1997).

12. Sales and Leases of Sleep Apnea Treatment Equipment May Be Exempt from Tax

If you sell or lease Continuous Positive Airway Pressure (CPAP) equipment to individuals for the treatment of a sleep disorder such as sleep apnea, your sale or lease may be exempt from tax.

Sleep apnea, described as a syndrome in which the sufferer periodically ceases to breathe during sleep, is currently treated with CPAP equipment, which continuously supplies a small amount of positive air pressure to the user's airway.

When used as a treatment for sleep apnea, CPAP equipment has been deemed a medical oxygen delivery system. This means that the sale or lease of CPAP equipment to an individual for the personal use of that individual, as directed by a licensed physician, is exempt from tax.

However, CPAP equipment used in this manner should be distinguished from similar devices that only assist the patient in breathing and *do not deliver air or oxygen directly into the patient's lungs*. The sale or lease of devices that only assist the patient's breathing process and, as such, do not deliver air or oxygen directly into the patient's lungs, remain subject to sales or use tax.

For more information concerning oxygen delivery systems and the application of tax to such systems, please contact our Information Center at 1-800-400-7115 and request a copy of Regulation 1591, *Medicines and Medical Supplies, Devices and Appliances*.

13. New Tax Reporting Option for Manufacturer-Lessors

Do you manufacture equipment? Do you lease that property to other manufacturers? If so, you can choose between two types of tax reporting methods for your leases. Effective January 1, 1997, if the lease meets the conditions described below, you can elect to report use tax based on the "cost price" instead of rental receipts (cost price is explained later). This will allow qualified lessees to claim a six percent income tax credit on their California income tax returns.

You can make this election if all of the following conditions are met:

- You manufactured the leased property;
- The property qualifies for the six percent income tax credit under Section 17053.49 of the Personal Income Tax Law and Section 23649 of the Bank and Corporation Tax Law;
- The property is leased to a qualified person, as defined in Revenue and Taxation Code 6377 (the lessee must have a manufacturer's exemption certificate issued by the Board of Equalization); and
- The property is leased in a form different



from the form in which you (the lessor) acquired it.

You must make this election on or before the due date of the return for the period in which the property is first leased. The election, which cannot be revoked, should be made by reporting use tax measured by the cost price on the return for that period. If you do not elect the cost price method, or if you do not make the election on a timely basis, you must report use tax based on rental receipts.

“Cost price” is defined as the price at which similar property has been previously sold or offered for sale. If the property has not been previously sold or offered for sale, the cost price is the total of the following:

- Cost of materials
- Direct labor
- The prorated share of manufacturer-based overhead costs
- Reasonable profit from the manufacturing operations

14. Oil Recycling Fee Has a New Home

If you file returns for the oil recycling fee, you should know that, effective July 1, 1997, responsibility for administering the program will be moved to the California Integrated Waste Management Board (CIWMB), which will mail out and process all future fee returns, beginning with second quarter 1997 returns.

Until June 30, 1997, if you have any questions regarding your account or the Oil Recycling Fee Law, please direct them to the Board of Equalization's Excise Taxes Division at 916-327-4208. After June 30, please direct your questions to the CIWMB at 916-255-2291.

The Board of Equalization has administered the fee program since its inception in October 1992. The fee is imposed on the first sale or use of lubricating oil in California.

15. Taxability of Prepaid Telephone Debit Cards

Prepaid telephone debit cards entitle a purchaser to make long distance telephone calls at a flat per-minute rate until the card expires or its value is fully depleted. They are usually sold in increments of \$5 to \$30.

In general, the sale of such cards is not subject to tax since the seller is considered to be selling a service rather than tangible personal property. The Board has determined that the true object of the sale is the future telephone service—not the transfer of ownership of a card. The card is incidental to the service.

However, *until the telephone service has been attached*, sales and purchases of the cards are considered sales and purchases of tangible personal property and are subject to tax.

The person who first sells the card with the service attached is considered the “consumer” for tax purposes, and sales or use tax will generally apply to his or her purchase of the cards. For example, a person may buy the cards from one party, contract for the telephone service from another party, and then resell the cards with the service attached. That person is considered the consumer of the cards, and sales or use tax will generally apply to the sale of the cards to him or her.

Note—cards purchased as collector's items: In some instances, a telephone debit card may be purchased for its collectibility rather than for the future telephone service. For example, an individual may purchase the card because it includes a graphic representation of a famous person or a “classic” automobile. When the card is purchased for this purpose, its sale is taxable. In this case, the true object of the transfer is the card itself, not the telephone service. This also holds true when the card is resold after the telephone service expires or is fully depleted. Again, the true object of the sale is the card, not the telephone service.



16. Claiming Credit for Prepaid Sales Tax on Fuel Purchases

If you are a retailer or other seller of fuel, when you purchase fuel from your supplier, you prepay that supplier the amount of sales tax that is due for each gallon of fuel sold to you. Since you will be reselling the fuel and reporting sales tax on those sales, you can claim a credit on Schedule G (form BT-531-GS) for the sales tax you prepaid to your supplier. You claim this credit by reporting the total number of tax-prepaid gallons delivered. Report the deliveries *for the reporting period in which you actually received the fuel*. Do not report the fuel based on when you ordered it or when it was invoiced or paid.

Reminder: As of April 1, 1997, the prepaid sales tax rate for purchases of motor vehicle fuel is 8 cents per gallon. For diesel fuel, the prepaid rate is 6.5 cents.

17. New or Revised Reference Material

If you would like to obtain a copy of any of the following reference material, please call the Information Center (see next column).

Sales and Use Tax Regulations

- 1529 Motion Pictures
(effective February 16, 1997)
- 1595 Occasional Sales—Sale of a Business—
Business Reorganization
(effective March 6, 1997)
- 1617 Federal Taxes
(effective February 22, 1997)
- 1702.5 Responsible Person Liability
(effective February 8, 1997)

New and Revised Sales and Use Tax Publications

- 31-S Tax Tips for Grocery Stores (Spanish)
July 1996
- 71 California City and County Sales and
Use Tax Rates —April 1997

18. Do You File Your Tax Returns Once a Year?

If so, the only *Tax Information Bulletin* you currently receive is the one mailed with your return. If you would like to be added to a mailing list to receive all four, please write to our Mail Services Unit and ask to be added to mailing list #15. Write to: State Board of Equalization; Mail Services Unit (MIC:12); Attn: Addressing Systems; P.O. Box 942879; Sacramento, CA 94279-0012.

For More Information

Information Center

Staff are available from 8:00 A.M. to 5:00 P.M., Monday through Friday, excluding State holidays. Call:

1-800-400-7115

For telephone devices for the deaf:

1-800-735-2929 (TDD phone)

1-800-735-2922 (voice phone)

Call the Center at any time to use the automated fax-back service or to leave a recorded message requesting a specific publication.

Internet

Visit us at <http://www.boe.ca.gov> for information on sales and use tax rates by county, publications, district office telephone numbers, public meetings, and so forth. Our web site is updated periodically.

Tax Evasion Hotline

If you believe a business should be reporting taxes and is not, you can call us toll-free to report it. Call during working hours at 1-888-334-3300.

Legislative Bills

Write to the Legislative Bill Room, State Capitol, Room B-32, Sacramento, CA 95814. The Bill Room does not provide copies of Board forms or publications.